

FINANCIAL RELATED AUDIT
OF THE
CHILD SUPPORT ACCRUAL METHODOLOGY
FAMILY INDEPENDENCE AGENCY
For the Fiscal Year Ended September 30, 1999

EXECUTIVE DIGEST

CHILD SUPPORT ACCRUAL METHODOLOGY

INTRODUCTION

This report contains the results of our financial related audit* of the Child Support Accrual Methodology, Family Independence Agency (FIA), for the fiscal year ended September 30, 1999.

AUDIT PURPOSE

This financial related audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Financial related audits are conducted at various intervals to permit the Auditor General to express an opinion on the State's financial statements. Also, this audit complements the departmentwide financial audit, including the provisions of the Single Audit Act Amendments of 1996, which is conducted pursuant to Act 251, P.A. 1986.

BACKGROUND

FIA's Office of Child Support attempts to recover, for the State, child support* payments made from noncustodial parents on behalf of their minor children. Recipients of public assistance must assign their rights to current, delinquent, and future child support to the State as a condition of eligibility. The assigned child support is used to repay the State and federal governments their respective shares of the public assistance granted to the recipients. Unless otherwise ordered by the court, the payment of all child support is through the county Friend of the Court offices. Also, Friend of the Court offices initiate and maintain income withholding orders* from noncustodial parents' employers and transmit support payments to the State when the children are recipients of public assistance.

The FIA child support accrual is a fiscal year-end accounting process designed to estimate material* accounts receivable and payable related to the child support collections retained by the State. The child support accrual process includes estimates of the child support receivable, unearned receipts payable due to the federal government, and accounts payable for State and federal incentive payments due to Friend of the Court offices.

FIA's child support accrual is a material accrual for FIA and the State. The Office of Financial Management, Department of Management and Budget, approved FIA's revised accrual methodology on November 9, 1999. Total child support collections received by the State on behalf of public assistance recipients in fiscal year 1998-99 were \$132.3 million.

* See glossary at end of report for definition.

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**AUDIT OBJECTIVE
AND CONCLUSION**

Audit Objective: To assess the reasonableness and completeness of FIA's child support accrual methodology for the fiscal year ended September 30, 1999.

Conclusion: We concluded that FIA's child support accrual methodology was generally reasonable and complete. However, our assessment disclosed a material

weakness* in FIA's internal control* over the child support accrual:

- FIA did not maintain sound internal control over the child support accrual (Finding 1).

FIA agreed with the recommendation and informed us that it will develop policies to periodically review the assumptions upon which the child support accrual is based and to independently review the process annually.

Our assessment also disclosed a reportable condition* related to FIA's estimation methodology (Finding 2).

**AUDIT SCOPE AND
METHODOLOGY**

Our audit scope was to examine the Family Independence Agency's child support accrual methodology that was followed for the estimation of the accrual for the fiscal year ended September 30, 1999. We examined the reasonableness and completeness of key factors and assumptions of the accrual methodology. Our audit was conducted in accordance with *Government Auditing*

* See glossary at end of report for definition.

Standards issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

AGENCY RESPONSES

Our audit report includes 2 findings and recommendations. FIA's preliminary response indicated that it agreed with both recommendations and will take the necessary steps to comply with them.

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Mr. Douglas E. Howard, Director
Family Independence Agency
Grand Tower
Lansing, Michigan

Dear Mr. Howard:

This is our report on the financial related audit of the Child Support Accrual Methodology, Family Independence Agency, for the fiscal year ended September 30, 1999.

This report contains our executive digest; description of the child support program and accrual; audit objective, audit scope, and agency responses; comment, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

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TABLE OF CONTENTS

CHILD SUPPORT ACCRUAL METHODOLOGY FAMILY INDEPENDENCE AGENCY

INTRODUCTION

	<u>Page</u>
Executive Digest	1
Report Letter	5
Description of Child Support Program and Accrual	8
Audit Objective, Audit Scope, and Agency Responses	10

COMMENT, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

Reasonableness and Completeness of Methodology	11
1. Internal Control	11
2. Estimation Methodology	13

GLOSSARY

Glossary of Acronyms and Terms	16
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Description of Child Support Program and Accrual

Child Support Program

A 1975 amendment to the Social Security Act added Part D of Title IV, entitled "Child Support Program: Child Support and Establishment of Paternity," and established the federal Child Support Program. The federal program is administered by the Office of Child Support Enforcement, U.S. Department of Health and Human Services (HHS). Michigan's Child Support Program operates through the cooperative efforts of three agencies: the Office of Child Support (OCS), Family Independence Agency (FIA); the county prosecuting attorney offices; and the county Friend of the Court offices. OCS is the Title IV-D agency responsible for administering the Child Support Program in Michigan. The county prosecuting attorneys establish paternity and obtain court orders for child support. The county Friend of the Court offices are operational arms of the circuit courts and enforce child support orders.

Child Support Accrual

Recipients of public assistance must assign their rights to current, delinquent, and future child support to the State as a condition of eligibility. The assigned child support is used to repay the State and federal governments their respective shares of the public assistance granted to the recipients. Unless otherwise ordered by the court, the payment of all child support is through the county Friend of the Court offices. Also, Friend of the Court offices initiate and maintain income withholding orders from noncustodial parents' employers and transmit support payments to the State when the children are recipients of public assistance.

The FIA child support accrual is a fiscal year-end accounting process designed to estimate material accounts receivable and payable related to the child support collections retained by the State. The child support accrual process includes estimates of the child support receivable, unearned receipts payable due to the federal government, and accounts payable for State and federal incentive payments due to Friend of the Court offices.

a. Child Support Receivable

FIA's estimation of the child support receivable determines child support collection revenue that FIA expects to receive in the next fiscal year for delinquent accounts as of the current fiscal year-end.

b. Unearned Receipts Payable

Federal law requires FIA to share child support collections with HHS. FIA prorates State child support collections with HHS based upon the federal Medicaid reimbursement rate in effect for the current fiscal year. FIA establishes an unearned receipts payable for the federal share of child support collections.

c. Accounts Payable for Incentive Payments

The State pays federal incentives monthly to county treasurers, on behalf of the Friend of the Court offices, to encourage operation of cost-effective and administratively efficient child support enforcement programs. The federal incentive payment formula takes into account Michigan's child support enforcement costs and collections. Based on the child support receivable, FIA establishes an account payable for the amount of the federal incentive payments expected to be paid to the county treasurers, on behalf of the Friend of the Court offices.

Also, each county treasurer receives, on behalf of the Friend of the Court office, an annual State incentive payment provided through the State Friend of the Court Incentive Payment Program, which was established by Act 298, P.A. 1982. FIA pays each Friend of the Court 3% of the child support collected by the court from noncustodial parents of public assistance recipients. Based on the child support receivable, FIA establishes an account payable for the amount of the State incentive payments expected to be paid to the county treasurers, on behalf of the Friend of the Court offices.

FIA's child support accrual is a material accrual for FIA and the State. The Office of Financial Management, Department of Management and Budget, approved FIA's revised accrual methodology on November 9, 1999. Total child support collections received by the State on behalf of public assistance recipients in fiscal year 1998-99 were \$132.3 million.

Audit Objective, Audit Scope, and Agency Responses

Audit Objective

The objective of our financial related audit of the Child Support Accrual Methodology, Family Independence Agency (FIA), was to assess the reasonableness and completeness of FIA's child support accrual methodology for the fiscal year ended September 30, 1999.

Our audit, relative to the objective for the assessment of the reasonableness and completeness of FIA's child support accrual methodology, complements the *State of Michigan Comprehensive Annual Financial Report* and the departmentwide financial audit of FIA, including the provisions of the Single Audit Act Amendments of 1996, which is conducted pursuant to Act 251, P.A. 1986.

Audit Scope

Our audit scope was to examine the Family Independence Agency's child support accrual methodology that was followed for the estimation of the accrual for the fiscal year ended September 30, 1999. We examined the reasonableness and completeness of key factors and assumptions of the accrual methodology. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Agency Responses

Our audit report includes 2 findings and recommendations. FIA's preliminary response indicated that it agreed with both recommendations and will take the necessary steps to comply with them.

The agency preliminary response which follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require FIA to develop a formal response to our audit findings and recommendations within 60 days after the release of the audit report.

COMMENT, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

REASONABLENESS AND COMPLETENESS OF METHODOLOGY

COMMENT

Audit Objective: To assess the reasonableness and completeness of Family Independence Agency's (FIA's) child support accrual methodology for the fiscal year ended September 30, 1999.

Conclusion: We concluded that FIA's child support accrual methodology was generally reasonable and complete. However, our assessment disclosed a material weakness in FIA's internal control over the child support accrual. FIA did not maintain sound internal control over the child support accrual. Our assessment also disclosed a reportable condition related to FIA's estimation methodology.

FINDING

1. Internal Control

FIA did not maintain sound internal control over the child support accrual.

FIA management is responsible for identifying and establishing processes to prepare accounting estimates, such as the child support accrual, that could be material to FIA's financial schedules. The child support accrual process estimates the child support receivable, unearned receipts payable due to the federal government, and accounts payable for State and federal incentive payments due to local agencies. The State's retention of child support collections results from public assistance recipients assigning their rights to current, delinquent, and future child support payments to the State as a condition of eligibility for public assistance. The assigned child support is used to repay the State and federal governments their respective shares of the public assistance granted to the recipients.

Sound internal control over the child support accrual process includes periodically reviewing key factors and assumptions, using relevant and reliable data to

compute estimates, and ensuring that the accrual is prepared in accordance with management's directives.

Our review of FIA's internal control over the child support accrual process disclosed:

- a. FIA did not have a policy requiring a periodic review of key factors and assumptions that support the child support accrual.

FIA's most recent review of the methodology's key factors and assumptions was in 1985. As a result, FIA's child support accrual methodology did not reasonably reflect declining trends in Michigan's public assistance case loads and child support collections. Also, FIA's methodology contained several key factors and assumptions that were not relevant.

For example, the number of recipients receiving public assistance directly affects the State's child support collection revenue. From fiscal year 1995-96 through fiscal year 1998-99, Michigan's public assistance case loads decreased 54% and child support collections declined 26%. However, the child support receivable recorded in these fiscal years increased 3%.

- b. FIA did not ensure that the data used to compute the child support accrual estimates was relevant and reliable.

FIA's fiscal year 1998-99 accrual estimates were based on collection data that was not consistent. Collection information reported through the State's accounting system and the Child Support Enforcement System* varied from \$127.7 million to \$132.0 million.

- c. FIA did not have a process to ensure that the child support accrual is independently reviewed annually.

* See glossary at end of report for definition.

Historically, FIA's Office of Internal Audit (OIA) has not reviewed the child support accrual. An October 8, 1999 memorandum from the State budget director requested all departmental internal audit offices to review the methodology and calculations of fiscal year 1998-99 material receivables and payables for reasonableness. Prior to our inquiry, OIA had not scheduled a review of the child support accrual and was not aware that FIA had revised its initial estimate. Subsequently, OIA informed us that it reviewed the calculations of the revised estimate, but would rely on our review of the accrual methodology.

Sound internal control would provide for OIA to annually review management's child support accrual methodology and computation. FIA's reliance on an external auditor is inappropriate as external auditors are not considered a part of, and are not responsible for, an agency's internal control system.

Although our analysis disclosed no material misstatements, sound internal control over the child support accrual would help to ensure reasonable estimates and minimize the risk of misstatement of the fiscal year-end child support receivable and related payables.

RECOMMENDATION

We recommend that FIA maintain sound internal control over the child support accrual.

AGENCY PRELIMINARY RESPONSE

FIA agreed with the recommendation and informed us that it will develop policies to periodically review the assumptions upon which the child support accrual is based and to independently review the process annually.

FINDING

2. Estimation Methodology

FIA did not ensure that its methodology for estimating the aging component of the child support receivable was reasonably reliable.

Department of Management and Budget Administrative Guide procedure 1210.27 states that, if an estimation approach is used to accrue revenues, the methods used must be documented, objective, reasonably reliable, practical, and consistently applied.

FIA determined its fiscal year 1998-99 child support receivable by estimating the amount of child support collections to be received in fiscal year 1999-2000 for accounts owed at September 30, 1999. A key component of the child support receivable is estimating the amount of revenue owed at fiscal year-end that will be received in the following fiscal year. However, FIA's estimation of this aging component was not based on current program conditions. FIA's estimation was based on a 1985 study of January 1985 child support collections. FIA staff stated that they were not familiar with the 1985 study and were considering conducting a new study in fiscal year 1999-2000.

Significant changes in the child support program and public assistance environment have occurred since 1985 based on State and federal welfare reforms. Michigan's public assistance case loads have decreased more than 63% since 1994. As case loads decrease, there is an associated reduction in child support collections received by the State for families on public assistance. Also, welfare reforms have given families a greater priority in receiving past due child support payments, which further reduces State revenues. In addition, more effective child support enforcement tools (such as immediate income withholding, uniform interstate child support laws, a national and State directory of new hires, an improved Federal Parent Locator Service, automated child support collection, and in-hospital paternity establishment) have greatly increased the State's ability to track and locate noncustodial parents to initially enforce their financial obligations.

Based on these changed conditions, we conclude that the aging component of FIA's estimation methodology was not reliable.

RECOMMENDATION

We recommend that FIA ensure that its methodology for estimating the aging component of the child support receivable is reasonably reliable.

AGENCY PRELIMINARY RESPONSE

FIA agreed with the recommendation and informed us that it will review the methodology for estimating the aging component of the child support receivable to make every effort to achieve reasonable reliability.

Glossary of Acronyms and Terms

child support	Money paid by a noncustodial parent for the living expenses of his/her child(ren). In addition, medical, dental, child care, and educational expenses may be covered by child support.
Child Support Enforcement System	A federally required automated system maintained by FIA that is designed to improve the sharing of child support information between county and State offices. The System contains computer programs related to the processing of child support court orders, including locating absent parents; cash receipting, payment distribution, and other financial transactions; and child support enforcement for delinquent accounts.
FIA	Family Independence Agency.
financial related audit	An audit that includes determining whether (1) financial information is presented in accordance with established or stated criteria, (2) the entity has adhered to specific financial compliance requirements, or (3) the entity's internal control over financial reporting and/or safeguarding assets is suitably designed and implemented to achieve the control objectives.
HHS	U.S. Department of Health and Human Services.
income withholding order	A court order that requires the noncustodial parent's employer (or other source of income) to withhold the amount of child support that the noncustodial parent is required to pay from his or her paycheck.
internal control	A process, effected by an entity's management and other personnel, designed to provide reasonable assurance

regarding the achievement of objectives in the following categories: (a) reliability of financial reporting, (b) effectiveness and efficiency of operations, and (c) compliance with applicable laws and regulations.

material	A significant element, account, or item of a financial statement or schedule.
material weakness	A condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the specified elements, accounts, or items of a financial statement/schedule being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.
OCS	Office of Child Support, Family Independence Agency.
OIA	Office of Internal Audit, Family Independence Agency.
reportable condition	A matter coming to the auditor's attention relating to a significant deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect FIA's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements/schedules.